Supreme Court, U.S.
FILED
APR 14 2000
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No. 99-1281

In The Supreme Court of the United States
OCTOBER TERM, 1999

O.S.C. & ASSOCIATES, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

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April 10, 2000

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REPLY TO BRIEF IN OPPOSITION

In his Opposition, the Commissioner states that the Tax Court, in upholding the Commissioner's determinations, applied the two-prong test of *Elliots, Inc. v. Commissioner*, 716 F.2d. 1241, 1243 (9th Cir. 1983). (Opposition at 4.) He also states that the court of appeals held that the Tax Court had correctly applied the two-prong test of. (Opposition at 5.) His conclusion follows that the application of that test was appropriate. The Commissioner is wrong.

Although the Tax Court cited the two-prong test approvingly (Pet. App. A6-A8), it did not apply it. Rather, it held that the "plan allocations were not made with compensatory intent and thus did not constitute compensation for services." (Pet. App. A8.) It considered all other arguments made by the parties and found them to be either irrelevant or without merit." (Pet. App. A9.) Consequently, it did not find it necessary to examine the "reasonableness prong" of *Elliots, supra.*

This is made clear in the opinion of the 9th Circuit: "Because we affirm the Tax Court's finding on lack of compensatory intent, we need not address OSC's evidentiary objections relating to the evidence of reasonableness." (Pet. App. A22.,

footnote 3 in original.) This is also addressed in footnote 1 of The Honorable Circuit Judge Wiggins' dissenting opinion where he refers to OSC's argument, which relied upon *Elliots, supra*, arguing

> "that the Tax Court should have utilized the five-factor test established in Elliots and allowed a deduction of the reasonable amount of compensation paid to Blazick and Richter. Although this argument was somewhat opaque in appellant's Opening Brief, the Commissioner clearly understood the argument and responded that no apportionment is required if the payments were made without compensatory intent: "**As is evident throughout taxpayer's brief, taxpayer apparently fails to comprehend the ultimate basis for the Tax Court's opinion in the case, which is that regardless of whether the payments in issue here were reasonable in amount, they were nonetheless not deductible because they constituted disguised dividends instead of compensation for services actually rendered**." (Pet. App. A25-A28.)(Emphasis added.)

The Honorable Circuit Judge Wiggins

correctly pointed out that the Petitioner's reliance on *Elliotts, supra*, was misplaced. The Elliots opinion:

> "addressed the appropriate analysis in cases involving payments made with compensatory intent that were unreasonable in amount. **Nevertheless, the relevant Treasury Regulations make clear that even if purported compensation payments were made without the requisite compensatory intent, the taxpayer is still entitled to a deduction equivalent to the reasonable amount of compensation paid to the shareholder-employees.** (Pet. App. A25) (Emphasis added.)

The Tax Court, with the approval of the 9th Circuit, has ignored the plain meaning of the Treasury Regulations and extensive case law which analyzes in each the case the reasonableness of the compensation paid by a corporation to a shareholder-employee. A new and improper threshold "compensatory intent" test has been created which will leave the compensation decisions of thousands of small businesses in turmoil and in uncertainty. This cannot and should not be tolerated.

CONCLUSION

This Court should grant the relief prayed for by OSC in its Petition.

Dated: April 10, 2000

Respectfully submitted,

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